Supreme Court, U.S.
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No. 88-646

In The

Supreme Court of the United States

October Term, 1988

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FIRST INTERSTATE CREDIT ALLIANCE, INC.,

Petitioner,

vs.

AMERICAN BANK OF MARTIN COUNTY, DOUGLASS E. WENDEL, TRUSTEE,

Respondents.

—o—

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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RESPONDENT, DOUGLASS E. WENDEL, TRUSTEE, BRIEF IN OPPOSITION

—o—

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STATUTES:

11 U.S.C. § 547(b) 3, 7

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11 U.S.C. § 550(a) 1, 3, 6, 7

ADDITIONAL STATUTE INVOLVED

11 U.S.C. § 550. Liability of transferee of avoided transfer.

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b) or 724(a) of this title, the trustee may recover for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

———o———

STATEMENT OF THE CASE

The Respondent, DOUGLASS E. WENDEL, hereinafter referred to as "Trustee", is basically in agreement with the statement filed by Petitioner, except for the following items which are included to correct any inaccuracy or omission in the statement, pursuant to Supreme Court Rule 34.2.

The Trustee does not agree with the Petitioner's characterization of the letter of credit transaction and believes that the facts are more correctly set forth in the opinion by the Eleventh Circuit. As set forth in that opinion, the parties originally agreed that the debtor would furnish a $20,000.00 bond to petitioner. The parties later agreed that the debtor's obligation to furnish a bond had been met by a letter of credit issued by American Bank

in favor of petitioner. The record reflects that a promissory note payable to American Bank was executed by debtor in the amount of $20,030.15, and that the note was secured by a $20,000.00 certificate of deposit, which was an asset of the debtor.

Petitioner characterizes the above transaction as being at the insistence of American Bank and further states, that it has no connection whatsoever with American Bank and that it had no involvement in procuring the letter of credit. The Trustee does not believe that these facts are contained anywhere on the record. The record merely reflects that documents were executed, and not that they were done at the insistence of any one party.

The Trustee also disagrees with the statement by petitioner that the District Court and the Court of Appeals held that the entire letter of credit transaction resulted in a preference because the debtor gave security to the issuer. Petitioner further goes on to state that the act of furnishing security at the bank's insistence resulted in a preference, thus transferring the risk of insolvency from the issuer to the beneficiary. The Trustee does not believe that this accurately portrays the Courts' decisions as the request for security was not the sole reason upon which the decisions were based.

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SUMMARY OF THE ARGUMENT

The question presented before this Court is more than whether a beneficiary who draws on a standby letter of credit receives a preference solely because the issuer requires a debtor to provide security. The Eleventh Cir-

cuit in this case found that Petitioner did receive a preference, and that all five elements of 11 U.S.C. § 547(b) had been met. Here, the beneficiary of the letter of credit was an undersecured creditor of the debtor, who received a letter of credit secured by a certificate of deposit owned by the debtor. The transfer of the certificate of deposit to secure the letter of credit created the preferential transfer. Under § 547(b) and § 550(a) of the bankruptcy code, this creates a preferential transfer. This case does not present the type of issues that should be considered by this court on a petition for certiorari. There is no conflict among the Circuits and the Circuit Courts that have considered the issue, have not departed from existing law.

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ARGUMENT

The question presented by Petitioner is whether a beneficiary who draws on a standby letter of credit receives a preference in bankruptcy, solely because the issuer required the debtor to provide security. The trustee believes that this misstates the question.

The lower courts basis' for a finding of preference was not solely because American Bank required the debtor to provide security. There are five different elements to a preferential transfer pursuant to 11 U.S.C. § 547(b). The Eleventh Circuit did find that it was the transfer of the certificate of deposit by the debtor to American Bank as collateral for the letter of credit that constituted the preferential transfer. The Eleventh Circuit was focusing in on the transfer of the debtors property that created the preference. At the trial court level, the Peti-

tioner had stipulated that most of the elements of a preference were present. The question as to whether property of the debtor was transferred was a disputed element.

At the district court level in this case, the New York Clearing House Association filed a brief as amicus curiae.[1] The sole issue addressed by Clearing House in its brief was the correctness of that portion of the trial court judgment that nullified the letter of credit issued by American Bank of Martin County to Petitioner. In its brief, Clearing House stated that they had tens of billions of dollars of letters of credits outstanding. The Clearing House opposed the language in the Bankruptcy Court's decision that nullified the letter of credit, arguing that it would needlessly erode the confidence that permits the letter of credit to play its essential role in thousands of commercial transactions every day. The decision by the District Court allayed the fears of the Clearing House by reversing that portion of the Trial Court decision that nullified the letter of credit transaction. The Clearing House did not move for rehearing in the District Court and did not appear before the Eleventh Circuit Court of Appeals.[2]

The District Court rejected the case of *In Re: Twist Cap, Inc.* in its decision.[3] *Twist Cap* was not cited in either brief to the Eleventh Circuit, and was not commented on

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1. *In re Air Conditioning Inc. of Stuart*, 72 B.R. 657 (S.D. Fla. 1987)

2. The Clearing House filed a Motion for Extension of Time to consider whether to move for reconsideration, but declined to do so.

3. *In re Twist Cap, Inc.*, 1 B.R. 284 (M.D. Fla. 1979). See also 72 B.R. at 662-663.

by the Eleventh Circuit. Petitioner again raises problems of *Twist Cap* in its petition to this Court. The Twist Cap case was decided on different grounds than the case before this Court and is no longer applicable.

Both the District Court and the Eleventh Circuit decision uphold the sanctity of the letter of credit transaction. Both Courts found that a preference existed under the particular facts of this case. Here, the purpose of the letter of credit transaction was to secure payment of an under secured antecedent debt, for the benefit of that undersecured creditor. The debtor pledged collateral to the issuing bank in order to obtain a letter of credit in favor of the creditor.[4]

Petitioner argues as it did in the Eleventh Circuit and District Court, that the transfer of the twenty thousand dollar certificate of deposit was for the benefit of the bank. Both the District Court and the Eleventh Circuit found that although the direct transfer of the Certificate of Deposit was to American Bank, it was clearly for the benefit of Petitioner as it indirectly secured payment of an undersecured antecedent debt owed by the debtor. The Court further found that the promised transfer of the Certificate of Deposit induced the bank to issue the letter of credit in the first place. Therefore, Petitioner did receive a benefit under 11 U.S.C. § 547(b)(1).[5]

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4. *In re Air Conditioning Inc. of Stuart*, 845 F.2d 293, 296 (11th Cir. 1988).

5. 845 F.2d at 296.

The Eleventh Circuit cited the case of *In Re: Compton Corp.* in its decision.[6] The Fifth Circuit had recently ruled on the same issues that were before the Eleventh Circuit. The Fifth Circuit opinion is also consistent with the reasoning of the District Court. The *Compton* case discusses in plain and clear language the same issues involved in this case and the legal basis for a finding of a preference. In *Compton,* a careful distinction is made that the transfer of debtor's property occurs when the debtor pledges its assets to secure a letter of credit. That Court held that although the letter of credit itself may not be property of the debtor, the collateral pledged as security for the letter of credit is. The transfer of property takes place at the time the letter of credit is issued and when the security interest is granted and not at the time that the issuer pays on the letter of credit.[7] Under this narrow set of facts, very few letter of credit transactions will fall within the definition of a preference.

The recovery of the preferential transfer from Petitioner is further supported by 11 U.S.C. § 550(a), which provides that a trustee can recover a preferential transfer from the entity for whose benefit the transfer was made. The District Court applied this reasoning in order to uphold the sanctity of letters of credit as vital instruments of commerce.[8] Petitioner has ignored § 550 in its argument that the independence doctrine has been ignored.

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6. *In re Compton Corp.,* 831 F.2d 586 (5th Cir. 1987). See also 845 F.2d at 295-296.

7. 831 F.2d at 590-591.

8. 845 F.2d at 299.

It has been argued by Petitioner that the existing letter of credit law which provides that a transaction can be set aside for fraud, protects the trustee. This is not so as fraud is not an element of proof under the preference law. This would make a letter of credit transaction harder to set aside than other preferential transfers.

Letters of credit should not be exempt from the operation of the preference rule. In the particular circumstance where the facts of the case warrant a finding of a preferential transfer, that statute should be applied. The application of the preference statute does not hamper the letter of credit industry. These arguments were considered thoroughly by both the Fifth Circuit in *Compton*, and by the Eleventh Circuit in this case. The trustee does not believe that financial markets have been disrupted by this decision. In the usual letter of credit case, the beneficiary of the letter of credit furnishes new goods or services in return for the letter of credit. These transactions are protected by the exceptions to the preference statute set forth in 11 U.S.C. § 547(c).

In this case, the beneficiary of the letter of credit received the benefit of debtor's property to secure payment of an antecedent debt. Under these particular circumstances, it is proper to apply the provisions of 11 U.S.C. § 547(b) and § 550(a) to find that Petitioner received a preferential transfer.

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CONCLUSION

There are only two circuits that have decided the specific issue before the Court. Both circuits have ruled consistently and Petitioner admits there is no conflict among the circuits. This case does not present the type of issue that warrants an exercise of this Court's power of supervision. The petition for certiorari should be denied.

Respectfully submitted,

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